

May 1, 2004

**HONORABLE MAYOR AND CITY COUNCIL:**

In preparing the 2004-2005 Proposed Operating Budget for the City of San José, the Administration faced an unprecedented task – bringing the City’s budget into balance while overcoming a third straight year of declining revenues and a forecast that shows little sign of recovery in the near term. The regional economic decline that began in early 2001 has persevered longer, and with greater severity, than the best economic experts predicted. Some have even argued that we are facing, not just a temporary downturn, but a new economic reality. Regardless of whether the current situation represents a permanent restructuring of our fiscal environment or simply a continuing temporary reversal, it is clear that the hoped-for recovery has not yet arrived. As a result, the budget decisions recommended to address the current situation must be viewed in the context of an enduring fiscal problem that will continue beyond 2004-2005 into future fiscal years.

The structural problem facing the City is clear. With shrinking revenues there is not enough money to continue providing the same level of services in all areas. This Proposed Operating Budget recognizes City Council priorities and focuses resources on essential services, on meeting basic infrastructure requirements, and on maintaining the City Council’s commitment to neighborhoods. City Service Areas (CSAs) have focused resources on core functions, ensuring the ability to continue providing high quality services in those core service areas even as we reduce the number and range of services provided. Service reductions, however, are only one piece of the solution. Restructuring and rethinking how we deliver services and ensuring that we use our resources as effectively as possible is another component. The City’s “One-Voice” effort highlights several of these new approaches, as does the reorganization of Strong Neighborhood Initiatives, and the Hub concept put forth as a new service delivery model for community centers. Finally, fee increases are proposed to ensure, as directed by the City Council, that opportunities for cost recovery are maximized.

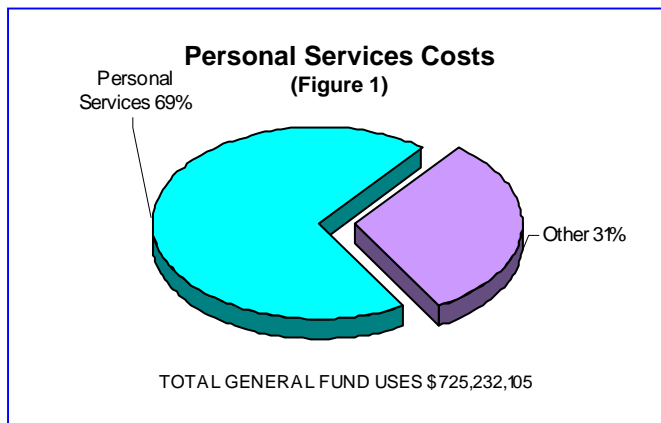
## 2004–2005 PROPOSED BUDGET MESSAGE

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As public agencies across the country face similar structural imbalances in their budgets, the national drive is to budget for outcomes, allowing policy-makers to view their decisions from the broader perspective and to better understand the service level impact of their decisions. In this regard, San José is perhaps better prepared than most to make difficult budgeting decisions. The City is in the 5th year of its performance-based budgeting program. Where services are reduced, the impacts of those reductions are reflected in related performance measures, allowing the City Council to better understand the results of its decisions and the impact of those decisions on our residents.

Overall, our situation looks strikingly similar to last year's, with some unfortunate exceptions. Once again, as the scope and depth of the downturn continued into the current fiscal year, new cost control strategies and operational adjustments were implemented to reduce the scale of service reductions that would be required to balance the 2004-2005 Operating Budget. Once again, per Council direction, we have had to establish in the Proposed Budget a set of more severe "Tier Two" reductions in the form of a *2004-2005 Compensation/State Budget Impact Contingency Plan* (in a separate section toward the back of this document) that would be necessary if there are changes to employee compensation assumptions or additional takeaways as a result of final State budget action. Once again, in spite of the difficult financial environment, this Proposed Operating Budget successfully balances projected revenues and expenditures while continuing to preserve to the maximum extent possible the most essential City services.

Unlike last year, however, certain strategies employed in formulating the current year budget, are now less available, such as the elimination of vacancies, the transfer of one-time funding, and the sale of property. Also unlike last year when we successfully trimmed programs to soften the impact, this year our residents will experience meaningful service reductions.



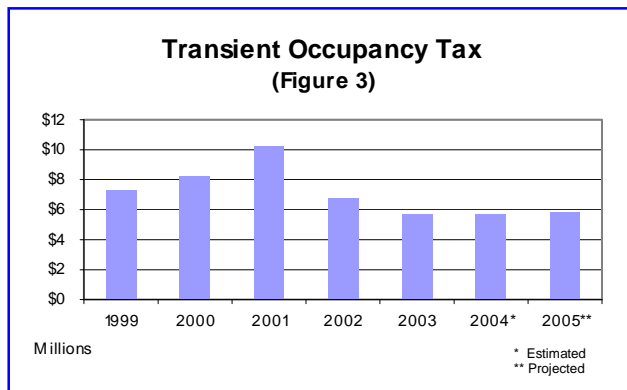
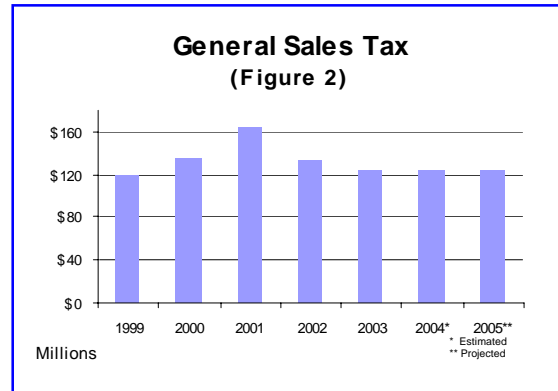
The City continues to confront a structural fiscal problem in the General Fund that must be addressed. Simply put, General Fund expenditures exceed General Fund revenues by a significant amount, and, as the Personal Services Costs chart shows (Figure 1) more than half of these costs (69% in 2004-2005) are directly tied to personnel costs. With financial forecasts continuing to display little if any sign of improvement in the near-term for the local economy, the 2004-2005 Proposed

Operating Budget assumes that there will be only minor growth in economically sensitive revenue sources through the 2005-2006 fiscal year. Further, the City contribution to all of its retirement funds has risen by more than \$30 million—the amount necessary to overcome the poor performance of the Retirement Fund portfolios that have been affected by the same economic downturn that has reduced City revenues.

As a result, a number of expenditure management actions were implemented early in the current fiscal year. These are detailed later in this Budget Message, along with the strategic budget balancing plan that closes the 2004-2005 revenue-expenditure gap while positioning the City for 2005-2006, when current projections show that the City will face a fourth year of significant fiscal challenges.

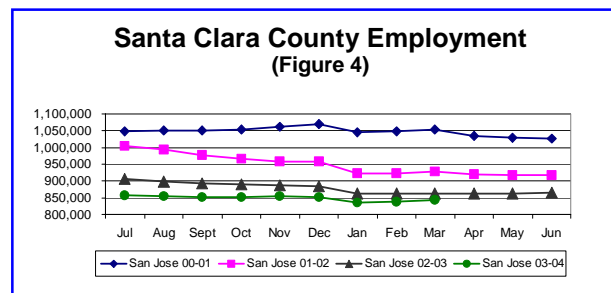
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Total General Fund revenue projections in the 2003-2004 Budget were \$638.2 million, and for 2004-2005 current projections place the base budget revenues number at \$624.1 million (not counting revenue generating recommendations included in the 2004-2005 General Fund balancing strategy). This represents an overall decline of \$14.1 million in 12 months and \$19.4 million over a two-year period. While the full significance of the economic downturn is detailed in the *General Fund Balancing Strategy Detail* (Attachment A), several noteworthy trends are highlighted here to call attention to the magnitude of the economic slump. In 2003-2004, the economy failed to sustain conservative revenue projections. Key revenues continued to decline. Sales taxes in 2003 (Figure 2) fell to levels approaching those collected in 1999, well below the predicted modest recovery anticipated one year ago. Similarly, Transient Occupancy Tax (TOT), which is tied to revenue from local hotel bookings, continued to slide. TOT revenues were projected to grow by 3% to \$6.7 million, but have under performed. While hotel occupancy rates have dropped slightly during the year (from 54% to 51%), the average per room charge has continued a decline that began before the events of 9-11



(dropping from an average of \$120 to \$111 this year), resulting in an overall decline in the Transient Occupancy Tax (Figure 3). The TOT projection was reduced by 10% at mid-year, and we now estimate receipts will fall below even that reduced level by another 5.5%. The most disturbing indicator of the enduring economic slowdown however, can be found in the job figures (Figure 4), which for Santa Clara County reflect a loss of 231,000 jobs since the peak in December 2000. While unemployment has begun trending down from its peak last year (9.1%), it still remains at an uncomfortably high 6.8%, and this rate remains above both the State and national averages. Most importantly we believe the reduction in the unemployment rate represents individuals leaving the job market, either through re-location or simply giving up seeking employment, since the number of jobs in the County has not grown at all during this period.

It is a reflection of the City Council's conservative approach to fiscal management that, despite the many negative economic factors influencing City finances, San José has maintained its strong AA+ bond rating, the highest of any major California city. While some economic indicators appear to be leveling off or showing slight improvement in the first quarter of 2004, there is no indication that a meaningful recovery is upon us. The revenue estimates included in this budget are based on the presumption that the local economy in 2004-2005 will



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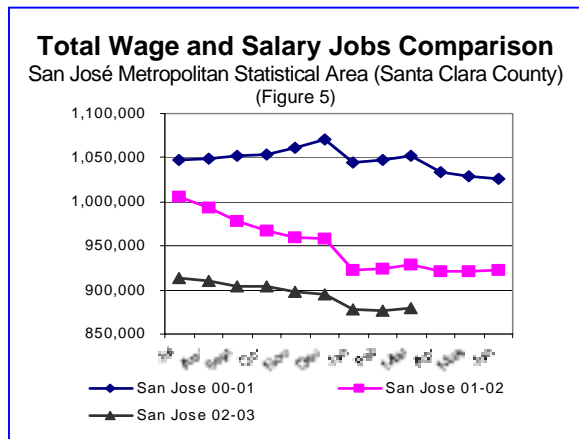
continue in its current depressed state, with only minimal growth in our economically sensitive revenue sources. Although there continue to be indications of a tenuous recovery at the national and State levels, there are few if any signs of significant improvement in the local economy to this point. We believe that jobs are the key factor in a local recovery and until there is some indication that significant job growth is starting to occur, we are presuming that the economy will remain sluggish.

### ECONOMIC OVERVIEW

One of the most significant challenges in formulating any budget is projecting the future condition of the local economy. This year, that challenge is particularly difficult as the unexpectedly long duration of the economic downturn has confounded even the best experts' prediction of a recovery. Because of the trend to move jobs offshore (many of which had previously sustained the local economy), it is difficult to predict how many of the more than 230,000 jobs lost since 2000, may be considered permanently lost. In addition, many of our largest tax-generating businesses have suffered severe revenue declines, and a significant number of businesses have simply closed. As a result, City revenues have suffered a severe decline. At the national level, and in other regions of the State there are signs of a recovery that may be gathering strength. Locally, although we appear to be emerging from the freefall of the last few years, there is little if any indication of growth in the near future. Unemployment is still high. Job losses continue in key business sectors, and economically sensitive City revenues remain stagnant. General sales tax receipts, the largest revenue source in the General Fund, dropped for ten consecutive quarters. Our most recent quarterly report ended that dubious streak by registering an anemic growth level of less than 1%. Finally, the uncertainty of our own economic situation continues to be exacerbated by the uncertainty of the impact of State budget balancing actions. These factors lead to a simple conclusion. The only prudent course is to presume for budgeting purposes that we will continue to face a continuation of the current stagnant economic situation through the entirety of 2004-2005, and the General Fund revenue estimates have presumed flat or only slight growth in the key economically related City revenues.

### Job Losses and Unemployment

The regional employment situation is the single most important factor in judging whether the economy is approaching a positive turn. The two sources of data that are monitored most closely as indicators of the Silicon Valley's economic health are wage and salary job gains/losses and the unemployment rate. Unfortunately, the recent performance of these two indicators provides little evidence that the local economy is on the verge of a significant recovery. Since the economy peaked in 2000-2001, the number of local jobs lost (Figure 5) has been stunning – approximately 231,000. Although the pace of job losses has declined, and we have recently even seen small job growth, there is still no indication that a sustained increase in jobs is here. Since last July, Silicon Valley has lost an additional 13,500 wage and salary jobs. Although this is significantly better than the more than 34,000 jobs lost during the same period last year, it occurs during a time when the State actually saw



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total jobs increase. While the recent leveling off of local job loss is welcome, the region would need several months of sustained job increases for a local economic recovery to take hold.

### **State Budget Problems**

The State of California, as has been well documented, continues to face significant budget problems. The strategy used by the State to balance last year's budget contained large elements of one-time actions, and guaranteed that California would face a huge shortfall going into the 2004-2005 fiscal year. While the recall of Governor Davis and election of a Governor Schwarzenegger has changed the nature of the debate, the budget balancing challenge continues to threaten local revenues. The new governor has indicated he is determined to create a structural fix to the current problems, and he has made reductions to local revenues a part of that strategy. The Governor's proposed budget, issued in January, contained proposals that would reduce local government revenues statewide by \$1.3 billion, and would cost the City almost \$10 million. Since that time, several alternative proposals for reducing local government revenues have been suggested by members of the legislature, and many of these would cost the City even more than the Governor's proposal.

### **BUDGET OVERVIEW**

In the 2004–2005 Proposed Operating Budget, the total net proposed funding is \$2,402,684,114 for all City funds (General, Special, and Capital). This is \$460,991,372 or 16.1% lower than the current 2003–2004 Adopted Operating Budget (Table 1 below). Under this spending plan, the total number of positions is decreased by approximately 6.6%, to a total of 6,737—the second straight year of significant position reductions.

<b>2004–2005 PROPOSED BUDGET – ALL FUNDS</b> (Table 1)			
	<b>2003–2004 Adopted</b>	<b>2004–2005 Proposed</b>	<b>% Change</b>
General Fund	\$ 824,235,522	\$ 725,232,105	(12.0%)
Special Funds	\$ 1,455,252,462	\$ 1,250,049,981	(14.1%)
<Less: Operating Transfers>	(\$ 756,877,083)	(\$ 582,077,340)	(23.1%)
<b>Net Operating Funds</b>	<b>\$ 1,552,610,901</b>	<b>\$ 1,393,204,746</b>	<b>(10.3%)</b>
Capital Funds	\$ 1,351,890,585	\$ 1,013,631,368	(25.0%)
<Less: Capital Transfers>	(\$ 10,826,000)	(\$ 4,152,000)	(61.6%)
<b>Net Capital Funds</b>	<b>\$ 1,341,064,585</b>	<b>\$ 1,009,479,368</b>	<b>(24.7%)</b>
<b>Net Total</b>	<b>\$ 2,863,675,486</b>	<b>\$ 2,402,684,114</b>	<b>(16.1%)</b>



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The General Fund portion of the City's Budget will decrease by 12.0% from 2003-2004, and totals \$725,232,105. This is somewhat misleading, however, in that it reflects the absence in the Proposed Budget of a significant amount of funding that was rebudgeted for multi-year projects at the end of the last fiscal year.

### **Budget Balancing Strategies**

It is important to view the current proposals in the context of cuts already experienced by the organization. In balancing the 2003-2004 Operating Budget, the City successfully closed an \$81.3 million deficit in the General Fund. In August 2003, the City Council acted to close an additional \$10.8 million funding gap resulting from State budget decisions made after the City's budget was approved (See Appendix: *2003-2004 General Fund Rebalancing Plan*). Our earliest projections for the upcoming year predicted a 2004-2005 General Fund gap of approximately \$55 million, more than half of which (\$29 million) was carried forward because of the use of one-time solutions to balance the 2003-2004 Operating Budget. A hiring freeze imposed in fall 2001 was extended. Under the freeze every requested position is reviewed by the Budget and City Manager's offices before being filled. Also extended, were the expenditure controls approved by the City Council in February 2003 on travel, meals, marketing, technology and vehicle purchases. In August, the Administration and City employees also committed to a Voluntary Furlough/Reduced Work Week Program that by February 2004 had achieved an additional \$633,000 in savings. In October, a detailed update of projections for the coming fiscal year revealed that the projected deficit had grown to \$85 million as a result of higher than anticipated health and retirement benefits costs combined with revenue projections that continued to fall below earlier estimates. In response, the City Administration imposed new cost management plans with a \$9 million reduction target that translated to a 1.25% reduction in Public Safety and a 3% reduction in all other CSAs. The savings produced from these reductions were placed in reserve for 2004-2005.

In February, the Five-Year Forecast updated each expenditure and revenue line item with the latest information. Due to the refinement of revenue projections and a reduction in payroll cost assumptions, the projected 2004-2005 General Fund gap was reduced slightly, to \$76 million. In February, confronting the continuing lack of improvement in the general economy and the City's fiscal condition, the City Council directed the Administration to bring forward recommendations that would immediately eliminate 100 General Fund vacancies (Table 2) to further close the City deficit (See Appendix: *2003-2004 General Fund 100 Vacant Positions*

*Elimination Plan* for details, Attachment B for all City Council referrals, and Attachment C for City Auditor referrals.) This action achieved \$6.3 million in projected 2004-2005 General Fund savings. This reduced the final shortfall used in this Proposed Budget to \$69.8 million.

<b>General Fund Vacancies Eliminated February, 2004 (Table 2)</b>	
<b>CSA</b>	<b>Positions</b>
Aviation Services	0.00
Economic & Neighborhood Development	4.00
Environmental and Utility Services	0.00
Public Safety	17.00
Recreation and Cultural Services	34.52
Transportation	12.00
Strategic Support	20.50
Council Appointees	11.00
<b>Total</b>	<b>99.02</b>

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With the continuing freeze on non-sworn hiring and the elimination of vacancies, the accumulated vacancy total currently stands at 450, down from 825 at this time last year. As part of the same Council action directing the elimination of vacancies, the Administration was directed to bring forward proposals that were likely to be included in the Proposed Operating Budget. Those recommendations have been developed and are agendized for Council consideration on May 4, 2004. (Appendix: *2004-2005 Proposed Operating Budget: Accelerated Proposals*).

As was the case last year, the strategic use of reserves will provide a part of the balancing solution. In February, the City Council directed that the Economic Uncertainty Reserve be used to balance the 2004-2005 Operating Budget *if* the City's bargaining groups would agree to a zero percent increase by April 1<sup>st</sup>. As of this writing, only one of the bargaining groups, OE3, has approved terms of a new contract, and that agreement *does* include zero percent in the first year. Other bargaining groups have so far not agreed to the zero percent option, but discussions with these other groups continue. In Tier One, the \$15.8 million reserve is not recommended for elimination. The Tier One proposal does, however, include the use of \$10 million of the \$16.5 million 2004-2005 Deficit Reserve. In addition, for the second consecutive year, no compensation increases are proposed for members of the City's management team.

Through the City's *StraightTalk on the Budget* communication effort, employees were encouraged to submit budget suggestions. Many City employees responded to the invitation with cost savings suggestions to address the City's budget shortfall. Each of the suggestions was reviewed to weigh the potential cost savings against possible service impacts. Some also warranted discussions with the various City bargaining units. The most frequently suggested ideas included:

- Early retirement programs
- Mandatory/voluntary reduced workweeks and unpaid furloughs
- Deferral of general wage increases/cost of living increases
- Increase employee cost sharing for various services/benefits
- Identify opportunities to have contracted services performed by employees

We will continue to review these and any new ideas received and will continue our discussions with the City's bargaining units to find new ways to save costs and protect services.

In developing the 2004-2005 Proposed Operating Budget, the Administration focused City resources on vital core services and Council priorities. Inevitably, as we faced the task of bridging another year of major General Fund shortfalls, every City Service Area including Public Safety was asked to participate with reductions and revenue enhancements. Tier One reductions in Police and Fire have been kept to a relative minimum in recognition of the City Council's expressed commitment to Public Safety, resulting in more severe service reductions in all other CSAs. The significant reductions proposed for the non-Public Safety CSAs has inevitably resulted in Public Safety reductions making up the largest component in the *Compensation/State Budget Impact Contingency Plan* (Tier Two). In preparing the 2004-2005 Proposed Operating Budget, the Administration followed the principles established in the *2004-2005 City Manager's Budget Request* and the *Mayor's March Budget Message* (See Appendix: *Mayor's Budget Messages* for details), approved by the City Council on February 10<sup>th</sup> and March 23<sup>rd</sup> respectively. Among these principles were:

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<b>Budget Balancing Principles</b> (Table 3)	
1.	Prioritize: continued provision of essential services to the community, reviving the economy, building strong neighborhoods, and stabilizing the City budget.
2.	Mitigate direct service reductions through the use of: ongoing expenditure reductions and new ongoing revenue sources; one-time expenditure cuts, one-time revenues; and strategic use of reserves designated for budget balancing purposes.
3.	Implement in the current fiscal year, those reduction proposals that would most likely be recommended for consideration as part of the 2004-2005 Proposed Budget
4.	Implement fee increases to assure that operating costs are fully covered by fee revenue.
5.	Explore opportunities to establish new fees for services where appropriate, including, but not limited to, an Emergency Response Fee;
6.	Recommend deferrals for capital improvement projects that create negative impacts on the General Fund;
7.	Defer new program commitments, unless they stimulate the local economy and job creation and/or are funded through redeployment of existing resources;
8.	Focus service reductions first in those areas that are least essential;
9.	Emphasize quality over quantity—do fewer things, but do them well;
10.	Balance proposed reductions across the organization and employee groups, including a careful review of all non-essential overtime and non-personal/equipment expenses;
11.	Make every effort to eliminate vacant positions, rather than filled positions; and
12.	Work together with employee bargaining groups to find ways to limit the number of employee layoffs.
13.	Continue to make employee involvement a priority for CSA budget balancing idea development, and ensure that an active budget communication plan with City employees is in place and utilized;

The resulting 2004-2005 Proposed Operating Budget relies on a combination of ongoing cost reductions, prudent proposals for fee increases, coupled with strategic use of reserves and one-time revenues. However, reductions account for almost half (41%) of the balancing actions. On the revenue side of the equation, a significant part of the solution is a proposal for an Emergency Response Fee (\$10 million) and for transferring revenues to support the General Fund. Among these transfers is a \$8.8 million reduction in the Traffic Capital Budget over the next 2 years. Also included are proposals to transfer a portion of the projected over-collection of Construction and Conveyance Tax Funds to help balance the General Fund and the conversion of uncommitted funds from that same source to a reserve for future Furniture, Fixtures and Equipment (FF&E) expenses. There are new proposals that cut costs but also should help us deliver services more effectively—the most significant of these being a proposal from the Recreation and Cultural Services CSA to centralize services around 16 hub and 11 satellite community centers. This reorganization provides for the continuation of After School and Senior Nutrition services, even as we close 10 small community centers and eliminate 36 positions. In Public Safety, another creative solution will shift



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duties associated with the Curfew Program and patrolling the Entertainment Zone to on-duty patrol personnel, thereby reducing \$576,000 in costs.

The service reductions contained in this proposal are serious and will be felt by our residents. Reductions affect all levels of the organization from management to front line workers and affect every CSA. The resulting recommendations will necessarily focus the City Council decision-making process, not on whether to cut or where to cut, but rather on how much to cut in all areas. In Recreation and Cultural Services, Parks Maintenance would be significantly downsized, and the number of Safe Schools Campus Initiative teams would be reduced. In Public Safety, several specialized programs would be reduced or eliminated to maintain the core functions of the department. In Transportation, the Traffic CIP would be reduced, as would the Landscape and Pavement Maintenance programs. A spending cap would be imposed on City-reimbursed sidewalk repairs. In short, there are no good or easy choices this year.

The table below shows the matrix of Tier One balancing strategies and the dollars associated with each action.

<b>General Fund Budget Balancing Plan</b> (Table 4)	
<b>SOURCE OF FUNDS</b>	<b>(In \$000s)</b>
2004-2005 Future Deficit Reserve (one-time)	10,000
Cardroom Revenue (one-time)	6,250
Emergency Response Fee	10,000
Business Information Management System	1,450
Sale of Surplus Property	1,000
Transfer from Other Funds	6,538
Miscellaneous	6,603
<b><i>Total Revenue &amp; Reserve Solutions</i></b>	<b><i>41,841</i></b>
<b>USE OF FUNDS</b>	
Position Eliminations/Efficiencies	(15,880)
Non-Personal/Equipment Reductions	(5,295)
Funding Shifts	(3,192)
Mayor, City Council and Appointees	(2,543)
Use of Reserves (Committed Adds)	(1,753)
Management Pay Increases/PDP	(1,822)
New Facilities (Operations & Maintenance)	1,025
Miscellaneous	1,467
<b><i>Total Expenditure Solutions</i></b>	<b><i>(27,993)</i></b>
<b>Total Balancing Solutions</b>	<b>69,834</b>

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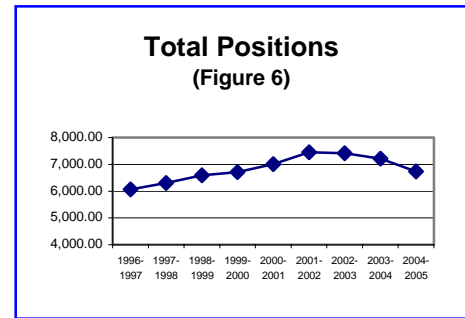
The Full-Time Equivalent position (FTEs) reductions contained in this proposed budget action are shown below:

<b>Position (FTE) Reduction Impacts (Table 5)</b>	
<b>Tier</b>	<b>FTEs Impacted*</b>
Tier One	285
Tier Two	265
Total	550

*\*FTEs include both vacant and filled positions.*

The position reductions in Tier 1 are in addition to the 99 positions that were previously approved for elimination on March 23, 2004, and 92 positions which were eliminated previously in 2003-2004, primarily as part of the State Rebalancing Plan and the planned removal of previously defunded and limited-dated positions. As Figure 6 demonstrates, the reductions imposed in 2003-2004 and those recommended in this Proposed Budget, have combined to reduce the City's total position count significantly, from the 2003-2004 Adopted Budget level of 7,213 down to 6,737 (a net reduction of 476) roughly equivalent to the number of positions in 1999-2000.

As noted earlier, the 2004-2005 Proposed Operating Budget is necessarily balanced with assumptions about things that have yet to occur, but which could have significant impacts on this proposal even after the City Council approves the final budget recommendations in June. Chief among these are future budget actions from the State, as well as changes to the assumption that compensation levels for City employees will remain at current levels in 2004-2005. Even as the City works to protect its interests in Sacramento and limit the impact on local services and revenues, this budget proposal recognizes that the State continues to face a \$14 billion deficit and the Governor and legislature have yet to resolve how much of the solution will be taken from local government. Consistent with the Mayor's March Budget Message, reductions contained in the *Compensation/State Budget Impact Contingency Plan* which would be considered in response to State actions, are not recommended for implementation at this time. However, a review of this list will reveal that these reductions would fall most heavily on the Public Safety CSA – the inevitable result of having held back the more serious Public Safety reductions in the Tier One recommendations.



### **Fee & Rate Increases**

As part of the 2001-2002 Budget process, Council initiated a strategy for phasing in increases to selected rates and fees across several years – once operational efficiencies had been demonstrated – to achieve cost recovery while softening the impact on customers. The 2004-2005 Proposed Budget continues this sound policy with recommendations to increase certain fees in Development Services (particularly Fire, Building and Planning) as well as to several user rates in the Environmental & Utility Services CSA.

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Development activity (planning permit applications, building permits, plan reviews and inspection activity) has remained relatively constant over the past three years following the historic boom that ended in 2000-01. To address fees that had become seriously out of step with costs – in some cases up to 40% below cost recovery – Council adopted for 2001-2002 a three-year phased plan for Planning fee increases and a two-year phased plan for Building fee increases. Some of the increase in the latter category was subsequently deferred to a third year to mitigate some of the impacts on development customers. Consultation and education of our development partners and the industry have been ongoing to ensure that service delivery remains a key priority. The proposed third phase of fee increases for Planning (7%) and Building (4.3%) would bring these to essentially full cost recovery (99%). Specifics of these proposals are addressed in the Proposed Budget, and more detail will be provided in the 2004-2005 Fees and Charges Report that will be published in early May.

The 2004-2005 Proposed Operating Budget recommends adoption of the second year of a two-year Recycle Plus rate increase package approved by Council in 2003, again raising rates by 9%. This would bring the program closer to cost recovery, but still keep those rates below the Countywide average in comparison to cities with similar services. The continued economic slump has resulted in higher vacancy rates and consequently lower levels of waste generation and disposal – and consequently reduced City revenues. The \$5.9 million generated by the proposed rate increase would offset this reduction in collection revenues, continue to move the program toward cost recovery, and bolster fund balances used for contingency reserves in the out-years. Additionally, the monthly cost for yard trimmings carts would increase to \$2.50 to achieve cost recovery for this subscription service.

Implementation of the third year of a three-year rate increase package approved by Council in 2002 for the Storm Sewer Operating Fund also is proposed. Revenue generated by the 4.5% increase would be used for a modest capital improvement program and to provide \$500,000 to replace and rehabilitate aging storm pump stations (nine of 21 are 40 years old or older), thereby reducing the risk of localized flooding in portions of the City.

The City's two water suppliers have again raised wholesale water rates by 7.6% and 13% respectively. The purchase of water accounts for over half of the budgeted use of funds and is by far the largest single expenditure. A proposed 4% adjustment to water rates in the Municipal Water System's service area would cover these increases. Also proposed is the indexing of wholesale recycled water rates to match the rates charged by the Santa Clara Valley Water District for untreated water.

A multi-year package of increases to the Sanitary Sewer Service and Use Charge fees is proposed. This was contemplated but not included in last year's budget process. After 10 years without a rate adjustment, a three-year package of 4.5% annual rate increases is necessary to address aging infrastructure needs at the treatment plant and improve its reliability in wet weather, cover increased costs to operate and maintain the sewage collection and treatment systems, and ensure the fiscal integrity of the fund.

### **Recreation and Cultural Services**

In this third year of budget reductions and with a work force already reduced last year by 98 positions, the Recreation and Cultural Services CSA has carefully assessed priorities and made

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difficult choices in reaching its recommendations for service reductions. The 2004-2005 Proposed Operating Budget recommends a reduction of almost \$11 million and elimination of 153.7 positions. As this budget was developed, we continued to look for new service delivery partners, to emphasize cost recovery, to reassess capital projects and to identify residents' priorities. Major core services that would be preserved include clean and safe parks, school safety, protecting youth and seniors, and building strong neighborhoods.

Moving toward self-service libraries would protect other vital functions at these key facilities as well. Nonetheless, a staffing reduction of 25 positions and strategic support service reductions in the area of \$1.5 million are recommended. Reduced hours of service would occur at some service points in the new Dr. Martin Luther King, Jr. Library, but at least in the Tier One budget branch hours would remain unaffected. While the Bookmobile and Disability Outreach Services would be eliminated, Library staff will continue to mail requested items to customers. The Library's Partners in Reading literacy program and PRNS' Office on Early Care and Education would be merged and managed by Library Services. The current service of reserving media materials (DVDs, CDs, etc.) and having them transported to the preferred branch would be eliminated. The materials would, of course, remain available at their current locations. A proposal to close all branch libraries one day per week would only be considered in the event Tier Two proposals are brought forth.

One of the most noticeable changes in service delivery would be that of community center services. Currently, 42 community centers, satellite community centers, and neighborhood centers are operated throughout the City by 115 staff. Community centers are fully staffed and offer a full range of programming, while satellite community centers may or may not be staffed, and neighborhood centers are generally non-staffed small facilities available for the community to rent. A new "hub" model is proposed that would consolidate community center facilities and staffing, focus on customer-identified priority programming, and generate close to \$2 million in operating savings to the City. Sixteen "hub" community centers would operate under the new model, supported by 11 satellite community centers, three neighborhood centers and a complement of 76 staff. This model focuses on quality over quantity of programming, and core services would focus on serving youth, seniors and disabled populations.

While priorities would still be focused on preserving services to youth and seniors at these community centers, some reductions would be inevitable in school-based programs. This proposal includes the elimination of five Safe and Accessible Integrated After School Program sites at elementary schools, affecting approximately 500 students. In addition, the Senior Employment Resource Center would be closed, and seniors would be referred to the Silicon Valley Workforce Investment Network and other community-based organizations (CBOs) providing similar services.

Finally, per Council direction, a 12.2% citywide reduction in support to CBOs occurs in Books Aloud, the Arts Venture Fund, and the Festival, Parade and Celebration program, as part of the overall direction to reduce CBO funding citywide by the average percent reduction suffered by all the non-public safety CSAs. Performance measures related to grant funding are unlikely to be affected because these measures are tied to the ratio of City funding to non-City funding. Despite the larger number of groups expected to apply for grants in 2004-2005, funding from non-City sources also has declined and ratios are therefore likely to remain constant. In addition, some arts programs would be reduced, and the Office of Cultural Affairs would eliminate two positions and shift focus from development activities to servicing core programs, such as grants, special events,

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arts education and public art. Avoiding reductions to core programs should minimize any decline in performance measure results.

In the area of neighborhood and regional parks maintenance, a reduction of \$1.7 million is recommended. The reduction would include the elimination of 25.25 positions, and service impacts would include closing park restrooms during the week, as well as reducing the frequency of trash removal, watering, and graffiti abatement. One option, should the City Council wish to soften this impact, would be to increase the transfer from the Parks Construction and Conveyance Tax Funds to the General Fund for parks maintenance purposes from 15% to 30%. The necessary amount has been held in reserve pending City Council action on the budget. Also included in this area is the recommendation to eliminate five positions that provide grounds maintenance at San José's major cultural facilities, and to explore consolidation of General Services-Neighborhood Parks Maintenance with PRNS-Regional Parks Maintenance. The consolidation of regional and neighborhood parks would be performed with priority placed on keeping parks and facilities clean and safe. Fees have been increased where possible, including aquatic fees and reservation fees at regional parks.

Safe schools remain a high priority, and budget recommendations focus on creating program efficiencies to minimize impact to school and community security. A reduction in the number of Safe Schools Campus Initiative response teams from eight to five is proposed, however, to realize \$784,000 in savings, with teams being housed in the aforementioned community center "hubs." Teams would continue to respond to immediate conflicts, as well as potential conflicts that are considered highly possible, but the ability to respond to conflicts rumored to occur would decrease by 40%. In addition, the budget for graffiti abatement would be reduced by \$264,000, with staff, supplies and education materials eliminated. Staff would be redirected to the most affected Strong Neighborhoods Initiative areas. Response time for graffiti removal as requested on the Anti-Graffiti hotline is expected to decrease slightly but the quality of the eradication efforts is not expected to decline.

Though these are very difficult economic times and challenging budget decisions to make, the Recreation and Cultural Services CSA has taken great strides to rethink City service delivery, build on and create new partnerships, and connect with residents and stakeholders to identify neighborhood priorities. We believe this new model of service delivery provides a solid foundation to build on and improve the delivery of recreation and cultural services to our community when additional funding again becomes available.

### **Building Stronger Neighborhoods**

Even with the restrictions imposed by the current fiscal environment, the City's commitment to our neighborhoods remains strong, as reflected in this proposed budget. The Strong Neighborhoods Initiative (SNI) is the core of the City's effort to build strong neighborhoods by developing community leadership and working collaboratively to deliver City services in response to neighborhood priorities.

In the 2004-2005 Proposed Operating Budget, SNI will continue to provide meaningful and visible change in San José communities in the five categories established by residents:

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1) affordable housing; 2) clean neighborhoods; 3) safe and attractive residential streets; 4) vital business districts; and, 5) parks and neighborhood services.

Over the course of the next five years, the City and the San José Redevelopment Agency are scheduled to invest more than \$100 million in these neighborhood priorities, although proposals are currently on the table in Sacramento for State budget cuts that would impact Redevelopment Agencies statewide and significantly threaten the San José Redevelopment Agency's ability to actually fulfill these plans. On 92 of the 193 "top ten" priorities identified by the neighborhoods, work is currently underway or will be initiated in the proposed 2004-2005 budget. But difficult budget times challenge the City organization to maximize service delivery by carefully aligning limited resources to neighborhood priorities. With the SNI work effort evolving from planning to implementation, the 2004-2005 Proposed Operating Budget reassesses staff capabilities and resource allocations. As a result, the Strong Neighborhoods Initiative core team is being reduced by 12.25 positions. The restructured team will reflect the City and Redevelopment Agency "one voice" approach to service delivery, aligning funding sources with work performed, and creating implementation teams that balance skills in the areas of project management and policy analysis. As proposed, the new team would consist of 20 well-trained and experienced staff supporting a new neighborhood configuration merging 19 neighborhood areas into six consolidated areas, for a General Fund cost savings of \$497,000. These smaller and more flexible and agile teams will provide greater accountability, clearer lines of responsibility and will work from the perspective and view of the neighborhood "driveway". Their efforts have also been integrated with the CIP team for delivery of neighborhood priorities and the Strong Neighborhoods Business Plan has been aligned with the seven City Service Area business plans to integrate service delivery.

Examples of this more effective service delivery model can be found in existing programs such as the driveway team, the vehicle abatement spotters project, retail and small business development teams, residential parking enforcement and neighborhood community policing. Staff resources have also been realigned at the Neighborhood Development Center (NDC) to complement the proposed SNI restructuring. Though reduced in total funding by \$49,000, the new NDC team would be better organized to support neighborhoods. Community Activity Workers currently assigned to individual neighborhoods would be reassigned to augment the existing staff at the NDC and create a larger pool of staff resources. Providing service to both SNI and non-SNI areas alike, the NDC will serve as a "hub" for neighborhood organizing, leadership training, resources for special events, technology resources, and access to community programs. This model will afford the opportunity for better coordination and increased flexibility in the City's response to neighborhood activities.

### **Economic and Neighborhood Development**

The Proposed Operating Budget responds to the economic challenges facing San José by focusing and prioritizing activities of the Economic and Neighborhood Development CSA around the Economic Development Strategy adopted by the City Council in December 2003. Our budget recommendations for this CSA therefore focus on 15 strategic initiatives to stimulate economic growth, as well as providing an adequate supply of safe, quality affordable housing, and continuing to assist and strengthen our neighborhoods – all while endeavoring to generate new operating revenues for the City, reverse the trends of declining sales tax and transient occupancy tax, and provide long term increases in property tax revenue.



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The proposed budget emphasizes the four the strategic initiatives that the City Council identified as priorities for 2004-2005:

- Develop strategic partnerships with San José State University and other universities to drive innovation and economic impact;
- Evolve and position downtown as a unique creative and cultural center of Silicon Valley;
- Support the start-up and growth of local businesses, small and large, in tech as well as non-tech fields; and
- Diversify San José's economic base and preserve/create middle-income jobs.

The recommendations in this CSA would eliminate 24 positions and save just under \$5 million through increased efficiencies and service delivery consolidation, cost recovery efforts through fees for service, renegotiation of contracts and leases, reductions in subsidies to outside agencies, and staff reductions and restructuring. The overall intent is to maximize limited resources while minimizing service level impacts. While two filled administrative positions are recommended for elimination in the Office of Economic Development, the City's retail initiatives would be maintained under the one-voice mantle, by combining existing resources in Economic Development and the Redevelopment Agency to advance the effort.

The impact of the continued economic decline on Convention Center operations and revenues is reflected in the budget proposals, which eliminate 16 positions (7 vacant and 9 filled) from Convention Center Services. The Department has looked internally to identify efficiencies that would maximize its ability to reduce expenditures and maximize support of convention services so that, even with this reduced staffing, customer service and satisfaction levels are expected to remain stable.

Other proposals include expansion of the Silicon Valley Workforce Investment Network (SVWIN) program to emphasize assisting residents in accessing employment opportunities in bio/life sciences, software, retail, healthcare and hospitality, and reducing local small business chambers of commerce and Convention and Visitors Bureau subsidies by 12.2%, in accordance with the Citywide reduction in support to community based organizations.

The impact of Redevelopment Agency funding reductions on the City's housing effort can be found in Housing, where a \$393,000 reduction is proposed. A reorganization and management consolidation within the Housing Department (eliminating three and reallocating five positions) would improve efficiency and enable staff to continue to lead the region in affordable housing. Housing construction in the downtown areas continues at a strong pace, with over 600 units completing construction and another 1,700 in the planning and construction phase for 2004-2005. The sale of three City-owned parcels would also enable additional development of affordable housing units in other areas throughout San José. City loan and grant programs to increase and preserve the affordable housing stock will continue, although at a reduced level. Reduced Community Block Grant Funds have resulted in the elimination of two positions in Housing rehabilitation programs, which would continue to respond to emergency home repair needs of the City's lowest income residents.

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In the area of long-range planning and code enforcement, activities would shift from proactive enforcement to a more reactive model, however health and safety protections would not be sacrificed. Several balancing strategies are reflected in this budget, including staff reductions and redeployments, a phase-in of fee increases to approach 100% cost recovery and the use of reserves in fee revenues built from prior years. In addition, a surcharge would be established to fund the next comprehensive General Plan update, scheduled to begin in 2006.

The proposed elimination of two positions in Long Range Land Use Planning and the Strong Neighborhoods Initiative will effectively mean a reduction in service within the Special Projects/SNI teams in the Planning Services Division. However, the Strong Neighborhoods Initiative has largely moved from the planning phase into an implementation phase, and staffing reorganization in this program reflects this change.

Excellent customer service with a predictable and timely development review process will be maintained by emphasizing a facilitation approach and providing seamless “one-voice” service delivery. The ongoing dialog with development customers to set service goals and budget levels, resolve concerns and set priorities for continually improving the development process and customer service also continue. Major long-range planning efforts for Evergreen, Coyote Valley and the North San José will move forward.

### **Public Safety**

No area of public service is more essential to the public welfare than public safety. Yet, given the magnitude of the current shortfall facing the City, not even this City Service Area can be immune to the need for cost-saving proposals. Preserving essential emergency services is accomplished this year, at least in the Tier One budget proposal, mainly through redeployments from non-emergency response resources, reductions in certain specialty units, and implementation of various cost-saving measures that have limited impact on high priority service delivery.

A combination of actions is expected to result in the elimination 20 positions with savings of about \$6.9 million in 2004-2005. Proposals include redeployment of police positions in non-patrol functions to patrol duty, elimination of specialty programs such as Challenges and Choices and the Curfew Program, and freezing or eliminating administrative positions in both Police and Fire. The CSA is moving ahead with consolidating grant writing within the Police Department and exploring other opportunities to consolidate capital project management and public safety education functions.

In addition, one-time savings of about \$1.8 million could be realized in 2004-2005 through the proposed temporary reduction of one Police Recruit Academy, one Fire Recruit Academy, and one Fire Engineer Academy and through temporary reduction and funding shifts (from General Fund to Fire C&C) for fire apparatus replacements. The CSA will receive some administrative support funds from the Urban Area Security grant from the Federal government. These funds will reimburse the cost of managing this grant program for the San Francisco Bay region in 2004-2005 so that the City's General Fund will not be used.

Proposals to increase various Police Department fees are also included in the proposals to generate revenue of just under \$200,000, an increase of 7.7% above the 2003-2004 Adopted Budget. Included are increases to fees that the City Council previously approved to be phased in over a

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period of three or four years such as the Amusement Exhibitor and Location Permits, Amusement Device fee, and Cardroom Work Permit fee.

The full implementation plan associated with the passage of the Neighborhood Security Act Bond Measure is contained in the Proposed Capital Budget and Capital Improvement Program (CIP). This bond measure, which authorized the City to issue General Obligation Bonds in an amount not to exceed \$159 million to fund Police and Fire capital improvements, significantly increased the resources available to add, relocate, and renovate public safety facilities. The infrastructure improvements that can be implemented as a result of this funding will result in better response times to emergency incidents, enhanced public access to services, and better working conditions for public safety employees. The Proposed CIP does take into account, however, deferring for one or more years those projects with O&M impact on the General Fund.

With its 2004-2005 resources, the Public Safety CSA will:

- Provide essential emergency services in a timely and effective fashion
- Continue to meet EMS Paramedic Agreement contractual requirements
- Maintain and strengthen school partnerships related to gang and drug activity and crisis management
- Continue to protect the health and safety of Public Safety personnel
- Move forward with Bond projects that do not adversely affect operating expenditures
- Maintain and strengthen partnerships for identifying potential terrorism threats and Weapons of Mass Destruction (WMD) responses
- Expand opportunities for public outreach and training as feasible to make residents more capable of maintaining their individual safety
- Provide Fire Special Operations response for incidents with specific response needs such as urban fire and rescue, high-rise operations, hazardous materials incidents, aircraft responses, wildland fires, etc.
- Effectively investigate arson fires and aggressively pursue, apprehend, and prosecute suspects in these incidents
- Use grant funding to pursue inter-agency communications projects, in compliance with Department of Homeland Security directives
- Continue to put San José in the forefront of Homeland Defense in Northern California by continued active participation in the FBI's Terrorist Task Force and strong linkage with Homeland Defense

However, we must repeat a cautionary note. As indicated earlier in this message, additional cuts resulting from either State action or from employee compensation increases will require additional reductions that would fall most strongly in the Public Safety CSA.

### **Aviation Services**

The importance of the Norman Y. Mineta San José International Airport to the local and regional economy was reinforced this past fall during the City Council's Getting Families Back to Work Study Sessions and Council adoption of the Economic Development Strategy. San José's competitiveness as a global business center and travel destination clearly hinges on the City's ability

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to develop and operate a world-class airport, as demonstrated by these policy initiatives. While our goals for the Airport are high, the sustained economic downturn has created challenges to realizing the Airport's potential. Since September 11, 2001, the Airport has experienced a serious decline in passenger traffic to levels similar to 1998-1999, roughly a 22% drop from the 2000-2001 high of 13.9 million passengers. While passenger traffic has recently shown some indication of growth from 2003, no significant increase is assumed during 2004-2005.

With the City Council's recent certification that the City has met the Airport Security and Traffic Relief Act (ASTRA) requirements, the City is now embarking on a major capital program to construct the new North Concourse, followed over the next several years by the South Concourse and Central Terminal. The North Concourse will provide the space needed to meet federal security requirements for the permanent installation of explosive detection equipment and for an automated in-line baggage screening system. These improvements will enhance customer service and reliable security processing while reducing ongoing costs for temporary facilities.

During the fall, the Aviation CSA projected a 2004-2005 shortfall of \$21.1 million. A series of actions were taken to address the deficit, including the implementation of an Airport cost management plan with targeted expenditure reductions of \$5.2 million and a shift in debt service timing that creates \$4.2 million in one-time savings. Projections for both base revenues and expenditures were updated in January, further reducing the deficit by \$2 million.

In 2004-2005 the funding gap would be further closed with the recognition of \$1.7 million in additional Passenger Facility Charge reimbursements, the use of \$5.4 million of reserves, and \$1.2 million in reductions. The reductions are largely related to contractual service cutbacks and include elimination of curb monitoring staff plus reductions to terminal support, building and maintenance services. In addition, a \$426,000 reduction has been taken in the Airport Customer Facility and Transportation Fee Fund (Rental Car Transportation Fund) to bring shuttle service hours in line with both customer demands and revenue levels. All these actions combined have allowed the City to balance the Aviation Services 2004-2005 budget with a minimum impact to customer service levels.

These strategies place demands on staff to be innovative and creative in meeting the needs of our customers so that they will continue to choose San José as their airport of first choice. Cost management and control will continue to be a priority for the organization, and is vital so that the CSA can continue to be responsive to our customers, the community, and our partners. Customer service measures such as signage, interim facility modifications, and beautification of construction areas will help mitigate the disruption caused by aging infrastructure and intensive construction.

Limited business development resources will be focused on attracting new air service, such as the recent addition of JetBlue Airways service to New York's JFK Airport. In an increasingly global business environment, the enhancement of air service to key trade centers, including both domestic and international service, will be a key economic development objective. Finally, the City's commitment to operating the Airport as a good neighbor will continue through the acoustical treatment of properties in the expanded eligibility area. Construction on 313 units will be completed in 2004-2005, with an additional 238 units (primarily historical properties) awarded during the year. The Airport Neighborhood Services Group, which leads the Airports good neighbor effort, also will

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continue to perform outreach in the community by providing information and receiving input on proposed development and operational changes at the Airport.

### **Transportation Services**

To continue to meet the basic needs of residents during this sustained economic downturn, the Transportation CSA recommendations for 2004-2005 include difficult tradeoffs among preventative maintenance, long-term pavement rehabilitation, education programs, planning, and technology-based programs.

Recommendations for this CSA structure services around performance outcomes and prioritize services to minimize customer impact and retain the long-term condition of the City's transportation assets. Fees have been increased where possible, vendor contracts eliminated to bring service functions in-house, and staffing levels reduced to correspond with the current levels of funding resources available for CIP programs and projects. In total, 19.1 positions will be eliminated as part of more than \$2.7 million in proposed reductions. There will inevitably be a decreased ability to perform preventive maintenance on pavement and landscaping that will exacerbate conditions over the next several years until funding and staffing levels can be restored.

However, despite a reduction in funding levels due to declining private development activity and fewer regional transportation grant monies, the City will continue to provide viable transportation choices to San José residents in 2004-2005. As explained earlier in this message, the Traffic Capital Improvement Program faces a significant reduction. The reduction requires a significant realignment of staffing. Proposals to address the reduced workload would eliminate 11 positions (6 filled) and achieve a \$930,000 savings.

Fee increases and the elimination of vendor contracts as proposed will enable the City to continue to deliver safe, efficient and neighborhood-friendly transportation operations. Increased penalties on 16 types of parking infractions will bring San José's penalties in line with other Bay Area cities, while still remaining slightly below the average except in the area of safety-related penalties, which will be somewhat higher. In another cost-saving effort, City parking compliance staff will patrol City garages in 2004-2005, thereby eliminating a vendor contract without impact to this service function and generating a net benefit to the City of \$185,000. Finally, the elimination of 2 positions in the areas of Intelligent Transportation Systems will reduce the Department's ability to pursue service level enhancements.

While the 2004-2005 Proposed Operating Budget recommendations do allow the CSA to preserve and improve City transportation assets, residents will notice cuts in pavement maintenance and tree services. Funding for pavement sealing would be reduced by \$543,000 in the Capital and Operating budgets combined, while investments in corrective work would be maintained. The percentage of streets in acceptable or better condition would fall from 87% to 84% in 2004-2005, as funding for the 10-year street maintenance recovery plan would be severely reduced. We remain hopeful that the federal transportation reauthorization will provide critically needed resources, but timing is uncertain. The State's continued circumvention of Proposition 42 funds exacerbates this funding shortfall. Resources would be maintained, however, for emergency work and responses to citizen complaints.

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Staffing reductions in the area of traffic signs and markings would result in 71% of markings meeting guidelines in 2004-2005, down from 77% in 2003-2004. Safety-related repairs of signage will continue to be resolved promptly.

The Landscape Maintenance Program budget would be reduced by \$504,000, and the elimination of three positions in this program would reduce the frequency of landscape services from every three weeks to every four weeks. The percentage of landscapes maintained in good or better condition is expected to fall to 68% in 2004-2005 and continue to decline in subsequent years until funding can be restored. The City's popular sidewalk repair grant program would continue, but with a \$1,000 reimbursement limit (higher for properties with large frontages) to ensure availability of grants to the maximum number of residents.

### **Capital Improvements – Investing in the City's Infrastructure**

Against the backdrop of a flagging economy, the City's Capital Improvement Program continues to bring significant improvements to San José. Over the past four years, nearly 600 projects have been completed bringing roadway improvements, enhanced recreational and neighborhood park facilities, new libraries, and better police and fire facilities. In 2004-2005, nearly 180 additional facilities will be added to that list, including the new City Hall, two new libraries, major renovations to two community centers, numerous park and trail improvements, fire station upgrades, several new traffic signals, and utility infrastructure improvements. Major projects are also underway that support the City's economic development goals by addressing needs associated with the City's growth, including the expansion of the Airport, major roadway improvements and Intelligent Transportation Systems (ITS) projects that improve the flow of traffic, and the expansion of the Municipal Water System and the Sanitary Sewer System into Edenvale and North Coyote Valley.

The 2004-2005 Proposed Capital Budget totaling \$1.01 billion accounts for approximately 42% of the City's total proposed budget. Over the next five-years, investments in the capital infrastructure are expected to total \$3.29 billion. While both the one-year capital budget and the five-year Capital Improvement Program (CIP) are smaller than the ones adopted last year, this level of investment is still one of the largest in the City's history, continuing the "Decade of Investment" that is transforming much of the City's infrastructure. The City is now entering the fourth year in which the annual capital program has topped \$1 billion, and the Five-Year CIPs have been in the multi-billion dollar range.

It should be noted, however, that a relative few major initiatives are largely responsible for the healthy size of the CIP. These include the expansion of the San José International Airport and the renovation and expansion of the City's parks and community centers, libraries, and public safety facilities. Many of the remaining programs are either flat or down slightly from prior CIP funding levels.

As was the case last year, the expansion of the Airport is by far the largest component of the overall CIP. Approximately 42% of the 2004-2005 Capital Budget and 63% of the Five-Year CIP are dedicated to improvements at the Mineta San José International Airport. In the near term, the focus of this program will be compliance with federal security mandates. The largest of these security projects is the North Concourse Building. For the remaining non-security capital projects, the Airport Master Plan provides the overall framework for the expansion.



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As a result of the voter-approved bond measures, major investments continue in parks, community centers and libraries. In November 2000, General Obligation Bond measures were approved to support library projects (\$212 million), and parks projects (\$228 million). The City's public safety facilities are also undergoing major renovations and expansions as a result of the voter-approved Public Safety Bond Measure in 2002 that authorized the issuance of General Obligation Bonds in the amount of \$159 million for public safety projects. The Proposed CIP allocates \$402.9 million from these sources to continue building new library, parks and public safety facilities, as well as renovating and expanding many of the existing library and park facilities and fire stations.

Significant capital investments in the City's utility infrastructure also continue in this CIP, including major renovations to the Water Pollution Control Plant, and the expansion of the water and sanitary sewer systems into the Edenvale and North Coyote Valley areas.

It is important to note that these capital investments are being made at a time of severe economic difficulty for the City and the region as a whole. This level of funding is possible only because a number of the programs have dedicated revenue sources that are not tied directly to the economy or reflect voter-approved General Obligation Bonds that have provided an influx of resources to improve our libraries, parks and public safety facilities. For those programs that do rely on economically sensitive revenue sources, such as the Traffic Capital Program, the amount of funding available will be dramatically less than was available during the peak in the late 1990s through 2000-2001.

One of the major challenges in dealing with the contradiction between the availability of funding to improve our infrastructure and the daunting General Fund operating budget shortfalls has been to balance the need for the new and expanded facilities and the ability to operate and maintain these facilities. At the City Council's direction, the Administration has again evaluated the capital projects with significant General Fund operating impacts and included in the Proposed CIP specific recommendations to further defer a number of projects that would have a negative impact if completed in the next few years.

After careful analysis of the capital projects with operating and maintenance costs, the following proposed schedule changes in the Library, Park and Community Facilities, and Public Safety capital programs have been included in the Proposed CIP to lessen the General Fund operating budget impacts over the next three years:

- ***Library*** – Delay completion of West Side Branch from 2007-2008 to 2010-2011 and accelerate completion of the Willow Glen Branch from 2010-2011 to 2007-2008. This change would allow existing staff from the Willow Glen branch to relocate to the Evergreen branch upon its completion.
- ***Park and Community Facilities*** – Delay the completion dates of eight parks and community center projects to minimize the operating and maintenance costs in the General Fund. These deferrals include five community centers, two parks projects and one skate park.
- ***Public Safety*** – The opening dates for three new fire stations scheduled to come on-line during the next three years would be deferred by approximately 12 months each if this recommendation were approved. In addition, the relocation of one fire station is recommended for deferral to align its schedule with one of the new stations. The

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schedule for these stations was previously deferred in the last CIP based on the significant operating and maintenance costs associated with these facilities.

Combined strategies recommended in the Proposed CIP would result in the avoidance of a total of \$2.3 million in General Fund operating and maintenance costs in 2005-2006, \$6.4 million in 2006-2007, \$3.7 million in 2007-2008, and \$1.5 million in 2008-2009.

For more information on the capital investments planned for the next five years, please refer to the 2005-2009 Proposed CIP that is published as a separate document.

### **Environmental and Utility Services**

The Environmental and Utility Services CSA provides wastewater, garbage and recycling, storm water runoff, sanitary sewer, water and other neighborhood-based services that protect the environment, assist in the City's strong neighborhoods programs, and are necessary building blocks in the City's economic development strategy.

While the economic downturn has had a relatively limited impact on revenues for this CSA compared to those in the General Fund, a comprehensive review of programs was nevertheless undertaken to achieve the targeted reductions. Employees participated in several rounds of sessions aimed at reducing or enhancing services based on priority needs assessments. The net effect of all the proposals – reductions and additions – is a reduction of just over \$2 million in ongoing savings across the four special funds, most of which will have limited service level impacts. Among the actions proposed are:

- Converting seven vacant positions to provide front-line maintenance services at the Water Pollution Control Plant.
- Continue to hold other necessary positions vacant to provide opportunities for employees displaced from other CSAs.
- Adding funding for infrastructure maintenance, replacement and rehabilitation – primarily at the water pollution control plant and the storm sewer pump stations. Nine of the 21 pump stations citywide are over 40 years old and require significant rehabilitation.
- Expanding the street sweeping parking enforcement program by posting parking restriction signage on an additional 40 miles in targeted areas at a cost of \$213,000 – the second year of a multi-year strategy to boost the ability of street sweepers to clean neighborhood roads more thoroughly while preventing materials to pollute storm sewers and area creeks.
- Benefiting the General Fund through changes that include (a) restructuring the commercial solid waste franchise fee to generate \$490,000 in additional General Fund revenues, and (b) a funding shift of \$311,000 to the Integrated Waste Management Fund to protect neighborhood clean-up programs from General Fund cuts.
- Saving just over \$1 million across the CSA's special funds through efficiencies and reductions involving the water and watershed operations, marketing and outreach, and other support services.

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- Saving another \$911,000 through reductions to the Water Efficiency Program, reflecting the City's success over the last 10 years in reducing flows to the treatment plant.

This CSA relies only minimally on the General Fund and instead oversees a set of user fees based on cost recovery models. As described in the earlier section on fee & rate increases, the following rate increases are proposed:

- The second year of a two-year rate increase package approved by Council in 2003 would again raise Recycle Plus rates by 9%, bringing the program closer to cost recovery while still maintaining rates below the Countywide average when compared to cities with similar services. The monthly cost for yard trimmings carts would increase to \$2.50 to achieve cost recovery for this subscription service.
- Funding the third year of a three-year rate increase package approved by Council in 2002 for the Storm Sewer Operating Fund. Revenue generated by the 4.5% increase would be used for a modest capital improvement program and to provide \$500,000 to replace and rehabilitate aging storm pump stations, thereby reducing the risk of localized flooding in portions of the City.
- A 4% adjustment to water rates in the Municipal Water System's service area would recover the wholesale water rate increases of 7.6% and 13% levied by the City's two suppliers. Also proposed is the indexing of wholesale recycled water rates to match the rates charged for wholesale untreated water by the Santa Clara Valley Water District.
- After 10 years without a rate adjustment, a three-year package of 4.5% annual rate increases is also proposed for Sewer Service and Use Charge fees. These funds are necessary to ensure the fiscal integrity of the Sewer Service and Use Charge Fund, to address aging infrastructure needs and improve reliability in wet weather at the treatment plant, and to cover increased costs to operate and maintain the sewage collection and treatment systems.

### **Strategic Support**

The former Employee Services, Finance and Technology, and City Facilities and Equipment CSAs now comprise the consolidated Strategic Support CSA. To assist front-line operating departments in serving the community, this CSA provides recruitment, training, purchasing, technology, revenue collections, facility and fleet maintenance, protecting and investing the City's financial resources, and other support services.

With the City's unprecedented investment in capital projects, including the opening of a new City Hall in 2005 that will be more than double the size of the existing facility, the Strategic Support CSA faces a major challenge – despite a growing inventory, with the implementation of this budget there will be far fewer resources for maintaining, staffing and providing technology at previous operations and service delivery levels. The proposed budget reductions for Strategic Support total \$11.5 million and would result in the elimination of 63.09 full-time positions, of which 33.11 are filled and 29.98 are vacant. This would be in addition to 20.5 vacant positions that were eliminated in March 2004 as part of the Council's action to eliminate 100 vacant positions citywide. The savings from the 20.5 positions amounted to \$1.5 million. To gain efficiencies and address the technology needs of the

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new City Hall, network engineers and technicians from throughout the City have been consolidated and centralized in the Information Technology Department.

This CSA also supports the delivery of capital projects. Because of the reduced number of projects funded in 2004-2005 Capital Budget, a significant rightsizing of Public Works staff is recommended to better align staffing levels with the reduced workload. Recommendations for reductions include the elimination of 39 positions (11 filled) with a projected savings of \$3.3 million.

This is the third year of reductions, making it increasingly difficult to retain delivery of even basic core services at the desired level. Service impacts would be as follows:

- There will be further erosion of custodial services at City facilities and minor repairs will not be completed in a timely fashion.
- Additional reductions in fleet management staffing will impact timeliness of repair and decrease fleet availability. First priority will continue to be the repair of vehicles used for public health and safety.
- There will be further reductions to the number and variety of training courses. Computer training will be offered on a very limited basis. Training will instead be focused on three core programs: new employee orientation, mentoring, and the Leadership and Supervision Academy. In recognition of the Academy's success and the pivotal role it plays in meeting the future leadership needs of the organization, existing resources will be redeployed to offer two new programs that augment the Academy – an advanced course in leadership and a formal mentoring program. Both of these programs are designed to build the skill level of existing employees to better equip them to compete successfully for higher-level management positions in the organization.
- Technology staffing will no longer be available to provide night/swing shift support. Resources to support departmental needs during normal working hours are also reduced, impacting response times for technical assistance or repairs.

Despite these major reductions, however, the CSA will generate an estimated \$990,000 in additional revenues by implementing a business tax amnesty program. It has been several years since the last program was undertaken, which yielded additional revenues to the General Fund.

### CONCLUSION

This 2004–2005 Proposed Operating Budget successfully closes a \$69.8 million dollar shortfall through preemptive action to reduce current year expenditures and the coordinated efforts of every City Service Area to identify opportunities to be more efficient while reducing costs. As decisions are made regarding this proposal, we must not lose sight of the economic signs that fiscal relief is not at hand. In balancing this year's budget, we have in part relied on one-time solutions that should only be used in a limited manner. Just as we began this year with a sizeable gap, the legacy of last year's one-time solutions, this year 77% of the deficit will be closed with ongoing measures pushing some of this year's challenge to the 2005-2006 budget.

Given the unprecedented and enduring economic decline experienced in the past three years, the Administration believes the proposed mix of reductions, one-time solutions, and use of reserves

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represents a sound approach to balancing the budget. Further it holds true to our commitment to provide essential services, meet the City's basic infrastructure requirements, and maintain the City Council's commitment to neighborhoods. Through consolidation, reorganization and by identifying efficiencies, it continues the programs and policies that the City Council has established as organizational priorities, from SNI to implementation of the Economic Development Strategy. At the same time, this is a plan that continues the sound financial discipline that has allowed us to manage through the current economic downturn.

It should be noted also that the 2004-2005 Proposed Budget document has been significantly reorganized, completing the transition to a performance-based budget presentation. The budget is now completely organized around expanded City Service Area sections, with the City Department sections in the back carrying only technical budget information as a reference. The new format is intended to support the City Council's ability to focus on a more policy and performance oriented discussion of the very difficult budget decisions facing it this year.

I appreciate all of our dedicated City employees for their involvement and understanding, and to the City Labor Alliance, which this year worked closely with the Administration as we moved through a very difficult budget season. I also want to acknowledge the professionalism displayed by the City's Senior and Executive Staff, as well as the many other employees who made a direct contribution to the preparation and production of this document and to express my sincere appreciation for a job well done.

Del D. Borgsdorf  
City Manager